Report of Examination

of

Farmers Mutual Fire Insurance Company of

Jefferson County, Tennessee, Inc.

Everett L. Gantte, Secretary

1205 Gay Street, P.O. Box 398

Dandridge, TN 37725

RECEIVED

AUG 13 2004

Dept. Of Commerce & Insurance

Company Examinations

Examination made as of: December 31, 2003

Examiner: James T. Pearce and Robert S. Creel

Examination commenced: January 12, 2004

Examination completed: August 13, 2004

Date of Report: August 13, 2004

Examined as of: December 31, 2003

Last Examination as of: December 31, 2002

Commissioner Paula A. Flowers
Department of Commerce and Insurance
State of Tennessee
Nashville, Tennessee 37243

Commissioner:

Pursuant to your instructions, I have made an examination and submit the following report of the conditions and affairs of the

Farmers Mutual Fire Insurance Company of Jefferson County, Tennessee, Inc.

Dandridge, Tennessee

Officers

Title	Name	Address	Term Expires
President	L.C. Batson	Dandridge, TN	July 2004
Vice President	Danny Layman	Dandridge, TN	July 2004
Secretary & Treasurer	Everette L. Gantte	Dandridge, TN	July 2004

Directors:

Name	Address	Term Expires
Everette L. Gantte	Dandridge, TN	July 2006
Danny Layman	Dandridge, TN	July 2004
L. C. Batson	Dandridge, TN	July 2004

Compensation of officers, directors, appraisers, adjusters, et al:

President	$500 per year
Secretary/Treasury	$3,000 per year
Bookkeeper	$605 per week
Asst. Bookkeeper/Clerk	$495 per week
Directors	$25.00 per meeting
Agents	$30.00 per meeting
Agent / Adjuster *	$15.00 per loss inspected (one payment per loss only)
Agent / Adjuster *	$15.00 per existing policy rewritten
Agent / Adjuster **	$30.00 per day or partial day (Jan. 1 – April 14, 2003)
Agent / Adjuster **	$0.35 cents per mile (Jan. 1 – April 14, 2003)
Re-appraisals (E. L. Gantte only)	$15.00 each (Jan. 1 – April 14, 2003)

* Received by all Agents, except E. L. Gantte prior to April 15, 2003 and received by all agents beginning on April 15, 2003.

** Received by E. L. Gantte regularly and L. C. Batson on occasion

Effective April 15, 2003, the Company stopped paying $15 per re-appraisal and $30 a day or partial day per new policy written, policy rewritten and loss adjustment and $0.35 cents a mile driven for each new policy written, each existing policy re-written and each loss adjustment visit made to their agents / claims adjusters.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination.

Premium Billing

The Company's premium assessment billing mailed in January was made on an annual pre-assessment basis for coverage written for the calendar year 2003.

Agent Compensation

Effective April 15, 2003 the Company would continue to pay their agents $15.00 for each loss adjustment inspection (one payment per loss only), each policy rewritten and each agent would be paid a salary as follows:

Mr. Danny N. Layman and Mr. A. L. Carpenter were paid a set annual salary of $2,520 or $210 on the 30th of each month. Mr. L. C. Batson was paid a set annual salary of $12,000 or $500 on the 15th and 30th of each month. Finally, Mr. Everett L. Gantte was paid a set annual salary of $60,000 or $2,500 on the 15th and 30th of each month.

Policy Coverage

Effective April 4, 2003, all policies with unpaid assessments were canceled.

Policy Exclusion

The Company in 2003 added an exclusion for wet rot, dry rot, bacteria, mold, fungi or other toxins except if they are produced as a result of fire and lightning.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination (continued).

Policy Exclusion

The Company in 2003 added a exclusion for losses that resulted from wear and tear, marring, deterioration, inherent vice, latent defect, mechanical breakdown, rust, corrosion, contamination or smog.

Policy Exclusion

Effective April 7, 2003, all losses on property insured will be repaired as near as possible to the properties condition at the date of the loss.

Policy Entrance Fees

Effective April 15 2003 the Company stopped charging Entrance Fees to new policyholders and stopped remitting the full amount of Entrance Fees to their agents.

Policy Coverage

In 2002 all policy forms issued noted coverage was extended for five (5) years from the policy issuance date. Starting in April 2003 all policy forms issued noted coverage was continuous. The Company can cancel any policy with five (5) days notice given to the policyholder and ten (10) days notice given to a policyholder that has a mortgage on the insured property.

Premium Rate Changes

Effective April 15, 2003, for all new business written, modular homes and double wide homes with asphalt / shingle roofs will be rated as a dwelling @ $10.00 per $1,000. All single wide mobile homes will be rated @ $20 per $1,000 including their contents.

Policy Effective Date

The Company's Board of Directors at their Annual Meeting on April 4, 2003 approved that all new policies written during the year would be written on an annual basis from the effective date of the policy. They would be billed annually from the policy anniversary date rather than in January with all of the other existing policies. Increases in existing insurance would be pro-rated for January annual billing.

Subsequent Events :

Premium Rate Changes

In January 2004 the Company billed its policyholders $10.50 per thousand (for all lines except mobile homes) and $21.00 per thousand for mobile homes (mobile homes were defined as those that did not have a porch or were underpinned) on a pre-assessment basis (billed in January 2004 for 2004 coverage).

Policy Coverage

Beginning in 2004 the Company would cancel all policies with unpaid assessments after 60 days from the billing date.

If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report?

Yes. Changes to the Company's By-Laws and policy forms are included with the work papers of this report.

Report on reinsurance assumed and / or ceded.

Type:	Property First Surplus
Reinsurer:	Farmers Mutual of Tennessee
Term:	Continuous contract, effective August 1, 1993.
Coverage:	Covers four (4) times the net retention to $100,000 maximum per risk.

Type:	First Aggregate Excess of Loss
Reinsurer:	Farmers Mutual of Tennessee
Term:	Continuous contract, effective January 1, 1993.
Coverage:	Covers 95% of $263,158 excess 70% of net written premium income.

Type:	Second Aggregate Excess of Loss
Reinsurer:	Farmers Mutual of Tennessee
Term:	Continuous contract, effective January 1, 1993.
Coverage:	Covers 95% of $263,158 excess of 70% of net written premium income plus $263,158.

Appraisal and classification of risks taken.

The Company may insure dwellings, barns, farming equipment and other implements usually kept in barns and outbuildings, church buildings and contents, school buildings and contents, household goods and electrical appliances. Livestock may be insured individually, as a group, or by classes of animal.

Annual rate of assessment per $1,000.00 for period covered:

	1999	2000	2001	2002	2003
Mobile Homes	$20.00	$20.00	$20.00	$20.00	$20.00
Other Lines	$9.00	$9.75	$9.75	$10.00	$10.00

The Company did not charge a deductible for claim payments.

Rate of membership, policy and initial fees charged.

Entrance Fee (Jan. 1 – April 15, 2003):	$5.00 per $1,000.00 (all lines except mobile homes)
Entrance Fee (Jan. 1 – April 15, 2003):	$10.00 per $1,000.00 (for mobile homes)
Transfer fee:	$1.00 or membership fee

Effective April 15, 2003 the Company stopped charging Entrance Fees and stopped remitting them to their agents.

Date of last assessment.

January 2, 2003 was the date of the last assessment covering January 1 through December 31, 2003. This premium assessment was due March 1, 2003.

Amount delinquent.

The Company had arranged payment schedules for twelve (12) policyholders that were on fixed incomes or were otherwise financially challenged.

Did that assessment provide for all losses, expenses and other liabilities, including borrowed money?

No. The 2003 premium assessment did not provide for all 2003 losses, expenses and other liabilities, including the year ending 2002 $140,000.00 outstanding principal loan balance payable to First Tennessee Bank which was carried over from the 2002 business year.

The $140,000 outstanding principal amount borrowed from First Tennessee Bank and $3,953.98 interest was paid in full on February 14, 2003.

Amount of money borrowed since date of last assessment.

The Company in 2003 borrowed $205,000.00 under the terms of a line of credit agreement with First Tennessee Bank. The Company repaid $5,000.00 out of the $205,000.00 principal amount borrowed in December 2003. As of December 31, 2003 the Company had a line of credit principal balance of $200,000.00. The Company repaid the $200,000.00 outstanding principal amount to First Tennessee Bank in four (4) total payments starting in January 2004 and ending in February 2004.

Exhibit of Risks

		Amount
1.	In force, December 31, 2002	$42,313,050
2.	New Business Written in 2003	$2,606,900
3.	Business Renewed in 2003	$5,583,100
4.	Total	50,503,050
5.	Deduct those expired and marked off as terminated	($8,746,650)
6.	Deduct Amount Reinsured in 2003	($10,039,525)
7.	Net In force, December 31, 2003	$31,716,875

Financial Statement

Income

Gross Membership Fees		$3,788	
Gross Assessments	$422,296		
Deduct : Reinsurance Premiums	(90,371)		
and Return Assessments	(4,754)		
Net Assessments		$327,171	
Borrowed Money		205,000	
Insurance Premium and Fire Marshall Tax Refund		22,190	
Re-Insurance Loss Adjustments		1,200	
Re-Insurance Sliding Scale Commissions Refund		12,866	
Miscellaneous Income		791	
Health Insurance Premium Refund (Maurice Cate)		1,090	
Total Income		$574,096	
Ledger Assets, December 31, 2002 per Examination		9,006	
Total Income and Balance			$583,102

Disbursements

Gross amount paid policyholders for losses	$301,143	
Deduct: Reinsurance loss collections	(126.008)	
Net amount paid policyholders for losses	$175,135	
Expenses of adjustment and settlement of losses	110,048	
Commission or brokerage, including membership fees retained by agents	3,788	
Salaries and compensation of officers, directors, & employees	50,428	
Office Supplies	3,132	
Postage	1,789	
Legal expenses	489	
Janitor, Building repairs & maintenance	6,894	
Taxes & Insurance	4,061	
Insurance department licenses and fees	13,408	
Withholding, Social Security, Medicare, and FUTA	17,078	
Borrowed money repaid (Principal - $145,000; Interest - $3,954)	148,954	
Utilities	4,767	
Group Health Insurance Premiums	30,355	
Miscellaneous expense	2,504	
Total disbursements		$572,830
Balance		$10,272

Assets

Cash in banks	$6,832
Petty Cash	10
Land and Building	*17,298
Total admitted assets per Company	**$24,140

* See the Investment in Home Office Land and Building heading under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

** See the Total Admitted Assets Per Examination heading under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Liabilities

Line of Credit principal amount borrowed	200,000	
Total Liabilities		200,000
Total Net Worth Per Company		***$(189,537)

*** See the Negative Net Worth (Surplus) heading under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Assets

Schedule of Bank Deposits:

Name of Bank	Amount on Bank Statement	Amount of O/S Checks	Adjustment Items	Balance
First Tennessee Bank	$15,793.24	$8,961.72		$6,831.52
Total	$15,793.24	$8,961.72		$6,831.52

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Land and Building: $17,298; Building consists of ½ of existing brick and block structure, carried at book value. The Warranty Deed states the Company bought the building from Florence H. Owens on November 30, 1966 for $8,000. The Company does not appear to have depreciated the original cost of the land and building based upon the $17,298 book value stated in the Annual Statement.

Cash Basis Accounting allows the Company to carry the land and building at market value. However, the Company has not had their land and building appraised and was not aware of the market value of the land and building as of year-end 2003. The $17,298 value stated in the 2003 Annual Statement appears reasonable based upon the historic downtown Dandridge, Tennessee location. Normally the $17,298 asset value for the Company's land and building as shown in the 2003 Annual Statement would have been admitted for purposes of this examination. However, Tenn. Code Ann. § 56-3-405 and Tenn. Code. Ann. § 56-3-402(15) only allows this investment up to 15% of admitted assets or $3,621.00. The admitted assets per examination as of December 31, 2003 were determined to be $24,139.00 before the land and building adjustment. See the Investment in Home Office Land and Building heading under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Assets pledged or hypothecated:

None. The Company pledged premiums receivable to First Tennessee Bank as collateral under the terms of a Line of Credit Agreement. Premiums receivable on a cash basis are not considered to be admitted assets of the Company.

Liabilities

Schedule of Bank Loans:

Name of Bank	Amount Outstanding	Balance
First Tennessee Bank	$200,000	$200,000
Total	$200,000	$200,000

Comments on claims, borrowed money and other liabilities:

The Company established a line of credit of $125,000 from First Tennessee Bank on July 25, 1995. Available line of credit has been modified to $225,000 in 1996; $275,000 in 1997; & $315,000 in 1998. In 2002 the Company borrowed a total amount of $140,000 against this line of credit. The $140,000 principal amount plus $3,953.98 interest was paid in full on February 14, 2003. The Company had no liabilities as of February 15, 2003.

The Company in 2003 borrowed $205,000.00 under the terms of a line of credit agreement with First Tennessee Bank to make up for insufficient income. According to the terms of the agreement the Company pledged future premium receipts as collateral. The Company repaid $5,000.00 out of the $205,000.00 principal amount borrowed in December 2003. As of December 31, 2003 the Company had a line of credit principal balance of $200,000.00. The Company repaid the $200,000.00 outstanding principal amount in four (4) payments in January and February 2004. The final principal payment of $30,000 was made on February 24, 2004 and included a $161.20 interest payment. The total amount of interest paid to First Tennessee Bank in 2003 and 2004 on the $205,000.00 amount borrowed was $3,553.23. The Company had no liabilities as of February 25, 2004.

According to the Company's Annual Statements and other records the total amount of money borrowed from banks from 1987 through 2003 was $2,960,000.

According to the Company's Annual Statements and other records the total amount of interest and loan fees repaid to banks from 1987 through 2003 was $136,066.56.

According to the Company's Annual Statements and other records the total amount of principal, interest and loan fees repaid to banks from 1987 through 2003 was $2,895,534.64.

The $205,000 amount borrowed in 2003 evolved from excessive compensation paid to directors, officers, agents / adjusters and employees during the 2003 business year and in previous business years. The Company could not repay the $200,000.00 December 31, 2003 outstanding principal amount before 2004 pre-assessments were returned by the policyholders in January, February and March of 2004. The move from post-assessment billing in 2001 to pre-assessment billing in 2002 did not eliminate the Company borrowing money in 2002 or 2003. The Company continued to pay an exorbitant amount of compensation to directors, officers, agents / adjusters and employees for salary, compensation, loss adjustment expenses, policy underwriting expenses and health insurance benefits.

The Company in order to continue to repay principal and interest borrowed ($148,954 or 35% of 2003 Gross Premium Assessments) from the previous year (2002) and the excessive amount of compensation paid to directors, officers, agents / adjusters and employees ($211,696.80 or 50% of 2003 Gross Premium Assessments) during the current year (2003) as well as net policyholder losses ($175,135 or 41% of 2003 Gross Premium Assessments), reinsurance premiums ($77,505 18% of 2003 Gross Premium Assessments) and other general business expenses the Company had to borrow $205,000. The Company since 1994 was in a cycle of borrowing money every year and repaying the principal and interest borrowed the following year (or second following year) when the majority (approximately 90%) of assessed premiums were paid by the policyholders in January, February and March.

Comments on claims, borrowed money and other liabilities (continued):

Claims appear to be paid promptly and to the satisfaction of the Policyholders.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:

Negative Net Worth

The Company's 2003 Annual Statement showed the Company had a negative net worth based upon the fact that it had liabilities totaling $200,000 and assets totaling $24,139.48 on a cash accounting basis. At year end 2003 the Company had a negative net worth of ($175,860.52). The Company has had a negative net worth on a cash basis since December 31, 1993 based upon Annual Statements the Company has filed with the Tennessee Department of Commerce and Insurance.

At year end 2003 the Company had an outstanding loan balance of $200,000.

Examination procedures using Tennessee Code Annotated, Title 56, revealed the Company had an even larger negative net worth as compared to the Company's 2003 Annual Statement. The examiners determined the Company had liabilities totaling $200,000 and assets totaling $10,463.00 on a cash basis. For purposes of this examination the Company had a negative net worth of ($189,537.00) at year-end 2003.

The Company repaid the $200,000.00 outstanding principal amount to First Tennessee Bank in four (4) total payments starting in January 2004 and ending in February 2004.

Director / Officer / Agent Compensation # 1

The Company was engaging in business practices that violate Tenn. Code Ann. § 56-22-130 "Person responsible for accepting or rejecting insurance shall be compensated otherwise than by commissions". Tenn. Code Ann. § 56-22-130 states "No officer or person whose duty it is to determine the character of risk and upon whose decision the application shall finally be accepted or rejected shall receive as any part of such person's compensation a commission upon the premium, but the compensation shall be a fixed salary, or such share of the net profits of the corporation as the directors may determine".

All of the Company's Agents were responsible for accepting or rejecting insurance applications. The Company up until April 14, 2003 paid each agent $15 per existing policy rewritten and loss adjustment inspection made (one payment per loss only) and $30 a day or partial day per new policy written, policy rewritten and loss adjustment and $0.35 cents a mile driven for each new policy written, each existing policy re-written and each loss adjustment visit made.

Effective April 15, 2003 all of the Company's Officer / Agents were only paid a $15 fee for each policy rewritten and loss adjustment visit made (one payment per loss only). The Company no longer remitted the $30.00 daily per diem and $0.35 cents per mile expense payments for underwriting new and existing policies and loss adjustment expenses. However, the Company was still in violation of Tenn. Code Ann. § 56-22-130 based upon the continued payment of $15 for each policy rewritten and loss adjustment visit made (one payment per loss only) to its agents.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Director / Officer / Agent Compensation # 2

The Company was engaging in business practices that violate Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses". Tenn. Code Ann. § 56-22-112 states that "the officers of the corporation shall not enter into any contract or agreement or make any debt of any kind, except for the payment of losses".

On May 25, 1989 the Company's Board of Directors approved "that a fee of $30.00 dollars per day or any part thereof, plus travel allowance of $0.25 cents per mile, be paid to Director Everett Gantte concerning re-insurance inspections, or for inspections or mileage incurred by Director Gantte if his assistance is requested by another Director or Agent regarding the issuance of coverage or loss inspections, or for any other reason pertaining to Company business".

From January 1, 2003 through April 14, 2003 the Company's Officer / Agent Mr. Danny N. Layman, Mr. L. C. Batson and Mr. Everett L. Gantte and Agent Mr. A. L. Carpenter were paid $15 per policy rewritten and loss adjustment visit made (one payment per loss only) and $30 a day or partial day per new policy written, policy rewritten and loss adjustment inspection and $0.35 cents a mile driven for each new policy written, each existing policy re-written and each loss adjustment inspection made.

Effective April 15, 2003 the Company's Officer / Agents Mr. Danny N. Layman, Mr. L. C. Batson and Mr. Everett L. Gantte and Agent Mr. A. L. Carpenter were only paid a $15 fee for each policy rewritten and loss adjustment visit made (one payment per loss only). The Company no longer remitted the $30.00 daily per diem and $0.35 cents per mile expense payments for underwriting new and existing policies and loss adjustment expenses. However, the Company was still in violation of Tenn. Code Ann. § 56-22-112 based upon the continued payment of $15 for each policy rewritten and loss adjustment visit made (one payment per loss only).

Also, the Company provided health insurance coverage for the following Directors / Officers / Agents: Mr. Danny N. Layman, Mr. Everett L. Gantte and Mr. L. C. Batson. Furthermore, the Company provided Health Insurance coverage for the following Agent and Bookkeeper: Mr. Alvin L. Carpenter and Julianne Martin. The Company's total cost of health insurance coverage in 2003 was $30,354.56 for the aforementioned employees.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Claim Repair Work

The Company appeared to be engaging in business practices that violate "Pecuniary Interest" laws set forth in Tenn. Code Ann. § 56-3-103.

Mr. Danny Layman at year-end 2003 was Director, Officer and Agent of the Company. Mr. Layman, also at year-end 2002, was the owner of Layman Construction Company (which was located in Dandridge, Tennessee). The Company would contact Layman Construction Company to repair structures that suffered loss due to fire, wind, hail or lightning that were insured by the Company. The checks issued in 2003 were written to Mr. Danny Layman and not Layman Construction Company. The policyholders did have the right to have any person or entity to repair structures that suffered loss that were insured by the Company.

On March 10, 2004 the Company's Vice President (Danny Layman) resigned his position as a Director, Officer, Agent and Claims Adjuster with the Company.

See the **Subsequent Events:** heading under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Investment in Home Office Land and Building

The Company's statement value of its home office land and building as of year-end 2003 was $17,298.00. Tenn. Code Ann. § 56-3-405 allows this investment up to 10% of admitted assets or $2,414.00. The admitted assets per examination as of December 31, 2003 were determined to be $24,139.00.

The Company's home office land and building was $14,884.00 more than the total investment maximum permitted by Tenn. Code Ann. § 56-3-405. However, Tenn. Code Ann. § 56-3-402(15) (or the "basket clause") allows the Company to invest an additional 5% of admitted assets in real estate for a total of $3,621.00 admitted assets per exam. Therefore, the Company's $17,298.00 statement value of its home office land and building as of year-end 2003 was overstated by $13,677.00 based upon Tenn. Code Ann. § 56-3-405 and Tenn. Code Ann. § 56-3-402(15). This $13,677.00 will be non-admitted for purposes of this examination.

Total Admitted Assets Per Examination

The Examiners deducted the $13,677.00 non-admitted portion of the Company's statement value of its home office land and building as of year-end 2002 in accordance with Tenn. Code Ann. § 56-3-405 and Tenn. Code Ann. § 56-3-402(15) in order to calculate the $10,463 Total Admitted Assets Per Examination.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Excessive Compensation of Directors, Officers, Agents and Employees
The Company appears to have paid an excessive amount of money to its officers / agents for compensation and loss adjustment expenses in 2003. The 2003 Annual Statement noted the Company paid $175,135.34 for policyholder losses (net of reinsurance) in 2003. The 2003 Annual Statement noted the Company paid $110,048.45 for "expense of adjustment and settlement of losses and agents compensation" or 63% of the amount the Company paid for policyholder losses (net of reinsurance) in 2003.

Company records obtained during the examination revealed that the Company paid Mr. Everett L. Gantte, Director, Officer and Agent of the Company, $96,158.48 in 2003 for new policies written, each existing policy re-written and each loss adjustment inspection made on behalf of the Company. The amount paid to Mr. Gantte constituted 87% of the Company's loss adjustment expenses and policy underwriting fees paid to its agents in 2002. Also, the $96,158.48 paid to Mr. Gantte for "expense of adjustment and settlement of losses and agents compensation" was 55% of the $175,135.34 amount the Company paid for policyholder losses (net of reinsurance) in 2003.

Based upon the Company's 2003 Annual Statement it appears the Company's cost of directors, officers / agents and employees salary ($50,427.99), agents compensation and expense payments ($110,048.45), membership fees retained by agent ($3,788.00), health insurance coverage ($30,354.56) and F.I.C.A. withholding, social security, medicare, state contributions and F.U.T.A. ($17,077.80) was a material amount of money to the Company. The total cost of all directors, officers / agents and employees' salary, compensation, expense payments and benefits (noted above) in 2003 was $211,696.80 or $36,561.46 greater than the $175,135.34 amount paid policyholders for losses (net of reinsurance) as listed on the Company's 2003 Annual Statement. Due to the cost of the officers, agents and employees' salaries, agents' compensation and expense payments, health insurance coverage and F.I.C.A. withholding, social security, medicare, state contributions and F.U.T.A., the Company had to borrow $205,000 from First Tennessee Bank in 2003 to pay employee related business expenses and losses. Tenn. Code Ann. § 56-22-112 only allows the Company to borrow money to pay losses.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Limited Internal Controls Governing the Company's Assets

On May 25, 1989 the Company's Board of Directors approved "that a fee of $30.00 dollars per day or any part thereof, plus travel allowance of $0.25 cents per mile, be paid to Director Everett Gantte concerning re-insurance inspections, or for inspections or mileage incurred by Director Gantte if his assistance is requested by another Director or Agent regarding the issuance of coverage or loss inspections, or for any other reason pertaining to Company business".

Also, on May 25, 1989 the Company's Board of Directors unanimously voted to require "Director Everett Gantte present a report showing dates of inspection, sites inspected, and mileage for each inspection, said report to be presented at the meeting of the Executive Committee."

The underwriting and loss adjustment expense reports that originated from the Company's Directors / Agents provided to the Examiners by the Company did not show dates of inspection, sites inspected, and mileage for each inspection. Also, these underwriting and loss adjustment expense reports provided to the Examiners by the Company did not show whether or not the policy underwritten or policyholder loss inspection was subject to the Company's reinsurance agreements with Farmers Mutual of Tennessee.

The Examiners were unable to determine the accuracy of the underwriting and loss adjustment expense reports submitted by the Company's Directors / Agents without the specific dates of inspection, individual site inspected and mileage traveled to each specific inspection. From January 1 through April 9, 2003 Director Everett Gantte submitted underwriting and loss adjustment expense reports that showed he worked 200 full or partial days (@ $30.00 per day equals $6,000), traveled 60,850 miles (@ $0.35 per mile equals $21,297.80), performed 598 re-appraisals for existing policies (@ $15.00 each equals $8,970) and 300 loss re-adjustments (@ $15.00 each equals $4,500). From January 1 through April 9, 2003 Director Everett Gantte was paid $40,767.80 for underwriting and loss adjustment work.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Reduction of the Amount of Insurance In-Force

It appears that as the expense of directors, officers, agents and employees' compensation continued to be paid in an excessive amount the Company's financial position deteriorated. Excessive employee compensation was the primary reason the Company had to borrow a total of $2,960,000.00 from 1987 through 2003 to pay policyholder losses, loss adjustment expenses and general business expenses. Also, the Company from 1986 until 2003 raised its premium assessment rate per $1,000 from $6.00 for all lines (including single-wide mobile homes) to $10.00 for all lines (including double-wide mobile homes) and $21.00 for all single wide mobile homes in order to repay loans, pay policyholder losses, loss adjustment expenses and general business expenses. During this period of time (1987 through 2003) some policyholders canceled their policies because they no longer could afford the steadily increasing premiums. A combination of exorbitant employee compensation and steadily increasing premiums was the primary reasons that from December 31, 1989 to December 31, 2003 Company's amount of Insurance In-force went from $95,213,281 (Gross of Reinsurance) to $41,756,400 (Gross of Reinsurance). The Company's total amount of insurance in-force (before reinsurance ceded) from year-end 1989 to year-end 2003 declined by $53,456,881 or approximately 44%. The Company did not record the number of polices in-force on their Annual Statements. Therefore, the examiners could not determine the amount of policy reduction from 1989 to 2003.

Insurance

Type: Assumption of Liability Agreement
Insurer: Farmers Mutual Hail Insurance Company of Iowa
Term: Effective January 1, 2002 and terminates January 1, 2003.
Coverage: Covers 100% of any amount paid or payable by the Company in excess of the policy limits, but otherwise within the terms of its policy, as a result of an action against the Company by its insured or its insured's assignee to recover damage the insured is legally obligated to pay to a third party claimant because of the Company's alleged or actual negligence or bad faith.

The Company had Employee Dishonesty, Commercial Property Coverage, Commercial General Liability Coverage, Commercial Inland Marine (for Accounts Receivable), Workers Compensation and Employers Liability (for Accident and Disease of employees) policies with State Automobile Mutual Insurance Company.

The Company provided Health Insurance coverage for Mr. Danny N. Layman, Mr. Alvin L. Carpenter, Mr. Everett L. Gantte and Julianne Martin.

The Company provided Medicare Supplement Insurance coverage through New Era Life of the Midwest for Mr. L. C. Batson.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Insurance (continued)
Also, the Company provided Cancer Insurance coverage through Continental Life Insurance Company of Brentwood, Tenn. for Mr. Danny N. Layman, Mr. L. C. Batson, Mr. Everett L. Gantte and Julianne Martin.

By-Laws
Article V, Section 1 of the Company's Bylaws states the Company shall have a Board of seven (7) Directors. Article V, Section 2 gives the President the responsibility to appoint vacant Board positions until the next annual meeting. At present, the Company only shows election of three (3) Directors. Tenn. Code Ann. § 56-22-126 states the Board of Directors shall not have less than six (6) members. Presidential appointments or additional elections were not listed in Board of Director minutes.

Statement of Accounting
This examination as of December 31, 2003 was conducted on a Cash Basis as compared to Accrual Basis accounting. The Annual Statement format for all Tennessee "County Mutual" Insurance Companies is based upon the statement of assets, liabilities, income and expenses on a cash basis.

Location of Books and Records
All of the Company's books and records were kept in its office building located at 1205 Gay Street in Dandridge, Tennessee, 37725.

Subsequent Events :

The following is a summary of the important decisions outlined on the Record of Minutes from the meetings of the Company's Board of Directors on February 25, February 26, March 3 and March 10, 2004, March 26, 2004 and March 27, 2004.

The Company's Vice President (Danny Layman) resigned his position as a Director, Officer, Agent and Claims Adjuster with the Company. From now on Mr. Layman will only repair losses with the approval of the policyholders that file claims for damage to their property resulting from fire, wind, hail and lightning. This action put the Company in compliance with this "Pecuniary Interest" law violation as set forth in Tenn. Code Ann. § 56-3-103.

The Company's Officers and Directors decided to stop paying its agents / claims adjusters $15 for each existing policy rewritten and loss adjustment visit made. The Company's agents / claims adjusters will only be paid a fixed salary. This action put the Company in compliance with Tenn. Code Ann. § 56-22-112 and Tenn. Code Ann. § 56-22-130.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Subsequent Events (continued):

The Company's Officers and Directors decided to stop paying for health insurance for its employees. This action put the Company in compliance with Tenn. Code Ann. § 56-22-112.

The Company's Secretary / Treasurer (E. L. Gantte) agreed to have his agent's salary reduced from $60,000 to $50,000 annually and eliminate his $3,000 annual officer salary. The Company's President (L. C. Batson) agreed to eliminate his $500 annual officer salary.

Directors would be paid $250 annually and at the end of the year. However, the Company would deduct $50 for each meeting missed from the $250 annual payment.

Eliminate unnecessary business expenses and restructure business insurance policies to reduce the amount of premium paid. The total amount of employee and business expense reduction was estimated to be $81,000 as compared to 2003 expense payments of $572,830.

The Company approved and appointed Alvin Carpenter, Larry Ramsey, Bill Smelcer and Jimmy Townsend to become Directors. This action put the Company in compliance with Tenn. Code Ann. § 56-22-126.

The Company started in 2003 and aggressively continued in 2004 seeking new business and re-underwriting each policy currently in-force. During this process the Company expects to increase insurance in force for those policies that are under insured and also re-evaluate each risk for insurability. The Company's goal is to increase insurance in-force and increase premium income in contrast to decreases in insurance in-force and premium revenue as in prior years.

Recommendations:

It is recommended that the Company implement the following measures of corrective action for purposes of complying with statutory requirements:

1. The Company should cease from compensating their agents who are responsible for accepting or rejecting insurance applications by any other method except by a fixed salary or share of the net profits as determined by the directors. This practice was in violation of Tenn. Code Ann. § 56-22-130 "Person responsible for accepting or rejecting insurance shall be compensated otherwise than by commissions".

   Subsequent to the date of examination, the Company's Officers and Directors decided to stop paying its agents / claims adjusters $15 for each existing policy rewritten and loss adjustment visit made. The Company's agents / claims adjusters will only be paid a fixed salary. This action put the Company in compliance with Tenn. Code Ann. § 56-22-112 and Tenn. Code Ann. § 56-22-130.

2. The Company should cease from executing any contracts or agreements with any individual or entity or make any debt of any kind, except for the payment of policyholder losses. The Company's employee compensation method of expense payments and health insurance coverage and unnecessary business expenses were in violation of Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses".

   Subsequent to the date of examination, the Company's Officers and Directors decided to stop paying its agents / claims adjusters $15 for each existing policy rewritten and loss adjustment visit made. The Company's agents / claims adjusters will only be paid a fixed salary. This action put the Company in compliance with Tenn. Code Ann. § 56-22-112 and Tenn. Code Ann. § 56-22-130.

   The Company's Officers and Directors decided to stop paying for health insurance for its employees. This action put the Company in compliance with Tenn. Code Ann. § 56-22-112.

Recommendations (continued):

3. The Company should cease from violating Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses". Due to the excessively high cost ($252,583.25 or $151,570.53 greater than the $101,012.72 amount paid policyholders for losses (net of reinsurance) as listed on the Company's 2002 Annual Statement)of the officers, agents and employees' salaries, agents' compensation and expense payments, health insurance coverage and F.I.C.A. withholding, social security, medicare, state contributions and F.U.T.A., the Company had to borrow $200,000 from First Tennessee Bank in 2003 to pay employee related business expenses and losses. Tenn. Code Ann. § 56-22-112 only allows the Company to borrow money to pay losses.

   Subsequent to the date of examination, the Company began the process of reducing the cost of employee compensation, eliminating unnecessary business expenses and restructuring business insurance policies to reduce the amount of premium paid. The Company as of May 13, 2004 had not borrowed any money.

4. The Company in 2003 paid their Vice-President / Agent, Danny Layman, owner of Layman Construction Company to repair structures that suffered loss due to fire, wind, hail or lightning that were insured by the Company. This was in violation of "Pecuniary Interest" laws set forth in Tenn. Code Ann. § 56-3-103. The Company should refrain from these actions.

   Subsequent to the date of examination, the Company's Vice President (Danny Layman) resigned his position as a Director, Officer, Agent and Claims Adjuster with the Company. From now on Mr. Layman will only repair losses with the approval of the policyholders that file claims for damage to their property resulting from fire, wind, hail and lightning. This action put the Company in compliance with this "Pecuniary Interest" law violation as set forth in Tenn. Code Ann. § 56-3-103.

5. At December 31, 2003, the Company only showed election of three (3) Directors. Tenn. Code Ann. § 56-22-126 states the Board of Directors shall not have less than six (6) members. It is recommended that the Company appoint at least three (3) more Directors to become compliant with Tenn. Code Ann. § 56-22-126.

   Subsequent to the date of examination, the Company approved and appointed Alvin Carpenter, Larry Ramsey, Bill Smelcer and Jimmy Townsend to become Directors. This action put the Company in compliance with Tenn. Code Ann. § 56-22-126.

Conclusion

It was determined that, as of December 31, 2003, the Company had admitted assets of $10,463 and liabilities, exclusive of capital, of $200,000. Thus, there existed for the additional protection of the policyholders, the amount of ($189,537) in the form of unassigned funds (surplus). For purposes of this examination the Company had a negative net worth of ($189,537) at year-end 2003.

The Company repaid the $200,000.00 outstanding principal amount to First Tennessee Bank in four (4) total payments starting in January 2004 and ending in February 2004.

Based upon the Company's financial condition as of year-end 2002 and 2003, the future of the Company as an ongoing concern is questionable. The Company's financial position had deteriorated to the point that it had to borrow money ($140,000) in 2002 and ($205,000) in 2003 to pay outstanding loans, losses and all other business expenses. Income during 2002 and 2003 was not sufficient to repay outstanding loan balances, pay policyholder losses, loss adjustment expenses and general business expenses, despite the Company having raised its premium assessment rates since 1986 from $6.00 for all lines (including single-wide mobile homes) to $10.00 for all lines (including double-wide mobile homes) and $21.00 for all single wide mobile homes. During this period of time (1986 through 2003) some policyholders canceled their policies because they no longer could afford the steadily increasing premiums as evident from the decrease of the amount of insurance in-force from $95,213,281 in 1989 (Gross of Reinsurance) to $41,756,400 in 2003 (Gross of Reinsurance).

If the Company's financial position follows the same pattern as in previous years its number of policyholders will continue to decrease as premium rates increase, the amount of insurance in-force will decline, the level of premium income will further drop and the Company will have to borrow more money in the future in order to pay outstanding loans, policyholder claims and all other business expenses.

The complete and courteous cooperation of Mrs. Julianne Martin, Bookkeeper and her assistants, Mr. L. C. Batson, President / Agent, Mr. Everett L. Gantte, Secretary / Treasurer / Agent and Mr. Danny Layman, former Vice-President / Agent extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner III, EIC

Robert S. Creel
Insurance Examiner II

Examination Affidavit:

The undersigned deposes and says that he has duly executed the attached examination report of Farmers Mutual Fire Insurance Company of Jefferson County, Tennessee, Inc. dated August 13, 2004 and made as of December 31, 2003, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner III, EIC
State of Tennessee

County Davidson
State Tennessee

Subscribed and sworn to before me
this 13th day of
August, 2004.

Helen W. Dorsey
(Notary)